

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

Case No. 04-42047 NCD
Chapter 13 Case

In Re:

Brian T. Peterson and
Ginelle M. Peterson,

Debtors.

**RESPONSE TO DEBTORS'
OBJECTION TO CLAIM**

Provident Bank/PCFS Mortgage Resources (“Respondent”), by and through its undersigned attorney, hereby submits this Response to the objection of Brian T. Peterson and Ginelle M. Peterson (“Debtors”) to the claim of Respondent filed in the above-captioned case. The facts relative to this matter are set forth in the Affidavit of William G. Selman III served and filed concurrently herewith. Those facts are as follows.

Debtors refinanced their home in 2002 through New Century Mortgage Corporation. Debtors signed a promissory note dated April 24, 2002 whereby they promised to pay New Century Mortgage Corporation the sum of \$228,000.00 at 8.5% interest, and, to secure the note, Debtors granted New Century Mortgage Corporation a mortgage dated April 24, 2002. The note and signed mortgage were subsequently assigned to Respondent, and Debtors were aware of the assignment. Debtors made approximately ten payments on the note and mortgage, but, thereafter, ceased making payments.

At some point, it was determined that the New Century Mortgage Corporation was not filed of record with the Sherburne County Recorder, and, in February 2004, Respondent commenced a foreclosure by action in Sherburne County District Court

seeking a court order directing the Sherburne County Recorder to accept a copy of the mortgage for recording and granting a decree of foreclosure of the mortgage. Respondent filed a Notice of Lis Pendens with the Sherburne County Recorder providing constructive notice of the pending Sherburne County District Court action.

On or about April 13, 2004, Debtors filed a voluntary Chapter 13 bankruptcy petition. In their schedules, Debtors listed Respondent as a general unsecured creditor, and, in the filed Plan, Debtors proposed to treat Respondent as a general unsecured creditor.

On or about May 24, 2004, respondent filed a secured claim with the bankruptcy court in the amount of \$252,160.52 pursuant to the mortgage on the homestead of the Debtors. Debtors have objected to Respondent's claim alleging that Respondent's claim is unsecured.

DISCUSSION

In their pleadings, Debtors contend that Respondent's claim is unsecured because the mortgage was not recorded. "Without a recorded mortgage, Provident cannot foreclose on its security interest. For that reason, Provident's claim is unsecured, not secured." Debtors' Memorandum. However, in making this argument, Debtors misconstrue Minnesota real property law, which establishes that Respondent maintains a security interest in Debtor's property.

As acknowledged by Debtors, the Bankruptcy Code defines "security interest" as "a lien created by an agreement," 11 U.S.C. Sec. 101(51), and defines "lien" as a "charge against or interest in property to secure payment of a debt or performance of an obligation," 11 U.S.C. Sec. 101(37). Under these definitions, Respondent has a security

interest. It is undisputed that the parties entered into a written agreement that intended to create a lien. Debtors signed and acknowledged the mortgage and ultimately made payments on the obligation.

However, Debtors erroneously contend that the failure to record the mortgage prevented the creation of a lien on the property. Under Minnesota law, a mortgage constitutes a “conveyance” of real estate, Minn. Stat. Sec. 507.01, and it is a well-established principal that an unrecorded conveyance is good between the parties to the conveyance. Scott v. Marquette Nat’l Bank, 173 Minn. 225, 217 N.W. 136 (1927); Seager v. Lamm, 95 Minn. 325, 104 N.W. 1 (1905). See Staples v. Miller, 319 N.W.2d 57 (Minn. 1982). The parties to the conveyance are well aware of the transaction, so one of them cannot claim ignorance. They are on notice of the transaction.

Judge Kishel has examined the impact of an unrecorded mortgage on a bankruptcy debtor’s real property. In In re Landmark, 48 B.R. 626 (Bkrtcy. Minn. 1985), Judge Kishel acknowledged the notice purposes of the Minnesota Recording Act, Minn. Stat. Sec. 507.34, and found that an unrecorded mortgage “attaches to the land upon acknowledgment and thereafter remains valid and enforceable as between the parties thereto.” Id. at 629 (citing to Seager v. Lamm, 95 Minn. 325, 104 N.W. 1 (1905)). As such, the holder of the unrecorded mortgage has an enforceable mortgage against the debtors’ property, and “[t]he mere fact that the mortgage was unrecorded did not make it unenforceable as against the subject real estate, and as against Debtors personally.” Id. Therefore, an unrecorded mortgage is a “valid lien against the real estate, and it remains so, provided it is not avoided by a party in interest.” Id.

Neither Debtors nor any other party in interest can avoid the mortgage. Debtors' objection to Respondent's claim is, in effect, an attempt to impermissibly avoid the lien. However, given Respondent's pre-petition filing of the Notice of Lis Pendens, such an attempt cannot succeed.

While Section 544(a)(3) of the Code provides that a trustee may avoid any lien avoidable by a hypothetical bona fide purchaser of real property, 11 U.S.C. Sec. 544(a)(3), case law establishes that a trustee with constructive notice is precluded from using its avoidance powers. For instance, in In re Collins, 292 B.R. 842 (Bkrtcy S.D. Ohio 2003), the trustee argued that 11 U.S.C. Sec. 544(a)(3) allowed the bankruptcy estate to avoid a mortgage which did not meet the requirements of Ohio law. The bankruptcy court held that, even though the mortgage was defective, the trustee could not use the strong arm statute because of a lis pendens filed against the property prior to the bankruptcy filing. Id. at 849. Once the lis pendens was filed, no one, including the trustee under Section 544(a)(3), could be considered a bona fide purchaser with rights over the holder of the mortgage. Id. (citing In re Periandri, 266 B.R. 651, 658 (6th Cir. BAP 2001)). As Colliers has stated:

However, the trustee's right as a bona fide purchaser does not override state recording statutes and permit avoidance of any interest of which a trustee would have had constructive notice under state law. This means a trustee generally can avoid an unrecorded transfer of land, but not after having been put on constructive notice or inquiry of a prior claim.

5 Collier on Bankruptcy, Para 544.08, 544-15 through 544-16 (15th ed. 2001).

In this case, Respondent filed a Notice of Lis Pendens with the Sherburne County Recorder. Under the Minnesota lis pendens statute, the sole function of lis pendens is to give constructive notice to subsequent purchasers and encumbrancers of the pendency of

the action. Minn. Stat. Sec. 557.02; Chaney v. Minneapolis Community Development Agency, 641 N.W. 2d 328, 333 (Minn. App. 2002). Therefore, the Notice of Lis Pendens precludes the avoidance of Respondent's interest in the real property.

The Notice of Lis Pendens also impacts this case in other ways. For example, a person or entity who purchases real property from a party after a notice of lis pendens has been filed takes that property subject to the final disposition of the pending action and is bound by the decision which may be entered against the party from whom the purchaser derives title. Marr v. Bradley, 239 Minn. 503, 59 N.W. 2d 331, 335 (1953); Fingerhut Corp. v. Suburban National Bank, 460 N.W. 2d 63,67 (Minn. App. 1990). In other words, a subsequent purchaser or encumbrancer takes their interest subject to the notice and, ultimately, the decision in the underlying legal proceeding involving the property. The notice of lis pendens remains on the property after the bankruptcy filing (it cannot be avoided), and the Chapter 13 debtors hold the property subject to that notice.

Debtors granted Respondent's predecessor a lien on their property, and the lien cannot be avoided under the provisions of the Bankruptcy Code. Accordingly, Respondent constitutes a secured creditor, and Debtors objection must be overruled.

Finally, Respondent notes that bankruptcy courts are considered courts of equity. Pepper v. Litton, 308 U.S. 295, 304, 84 L.Ed. 281, 60 S. Ct. 238 (1939); 11 U.S.C. Sec. 105(a). Principals of equity demand that Debtors not be allowed to succeed on their objection. It would be inequitable for a debtor to refinance their property, receive the benefit therefrom, file for bankruptcy before the mortgage was recorded and walk away with a dischargeable unsecured debt. Given the practicalities of mortgage recordation, all mortgages would be at risk under this scenario.

Should the Court so desire, Respondent would be agreeable to an evidentiary hearing on the issues presented by this claim objection.

CONCLUSION

For the reasons set forth above, Respondent respectfully requests that this Court issue an Order overruling Debtors' objection to Respondent's claim filed in this case.

Dated: September 21, 2004

/e/ William G. Selman III
William G. Selman III (#195716)
250 Second Ave. S., Suite 205
Minneapolis, MN 55401
Telephone: (612) 333-6000
Attorney for Respondent

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

Case No. 04-42047 NCD
Chapter 13 Case

In Re:

Brian T. Peterson and
Ginelle M. Peterson,

**AFFIDAVIT OF
WILLIAM G. SELMAN III**

Debtors.

STATE OF MINNESOTA)
) ss.
COUNTY OF HENNEPIN)

William G. Selman III, being first duly sworn upon oath, states and alleges as follows:

1. I am the attorney of record for Provident Bank/PCFS Mortgage Resources (“Respondent”) in the above-captioned matter, and I submit this Affidavit in conjunction with the Response to Debtors’ Objection to Claim served and filed concurrently herewith.
2. On May 24, 2004 Respondent filed a secured claim in the amount of \$252,160.52 by virtue of a mortgage on the homestead of the Debtors.
3. At the June 2, 2004 Meeting of Creditors in the above-captioned case, Brian and Ginelle Peterson (“Debtors”) testified as follows:
 - a. Debtors refinanced their home in 2002 through New Century Mortgage Corporation.
 - b. Debtors signed a promissory note dated April 24, 2002 whereby they promised to pay New Century Mortgage \$228,000.00 at 8.5% interest.
 - c. To secure the promissory note, Debtors signed a mortgage dated April 24, 2002 thereby granting a mortgage to New Century Mortgage Corporation.

- d. Debtors were aware that the above-referenced note and mortgage were assigned to Respondent.
 - e. Following the closing on the refinance, Debtors made approximately ten payments.
 - f. Subsequent thereto, Debtors discontinued all payments on the note and mortgage.
4. Apparently, the mortgage of New Century Mortgage Corporation dated April 24, 2002 was not filed of record.
5. In February 2004, Respondent commenced a foreclosure by action in Sherburne County District Court whereby Respondent sought a court order directing the Sherburne County Recorder to accept a copy of the mortgage for recording and granting a decree of foreclosure of the mortgage.
6. Respondent filed a Notice of Lis Pendens with the Sherburne County Recorder thereby providing constructive notice of the pending Sherburne County District Court action. A true and correct copy of the Notice of Lis Pendens is attached hereto Exhibit A.

FURTHER YOUR AFFIANT SAYETH NOT.

Dated: September 21, 2004

/e/ William G. Selman III
William G. Selman III (#195716)

Subscribed and sworn to before me
this 21st day of September, 2004

/e/ Lizzette Cordero
Notary Public

EXHIBIT A

STATE OF MINNESOTA
COUNTY OF SHERBURNE

DISTRICT COURT
TENTH JUDICIAL DISTRICT

The Provident Bank,

Plaintiff,

Court File No. _____

vs.

NOTICE OF LIS PENDENS

Brian T. Peterson and Ginelle M.
Peterson, Northland Credit
Corporation, Tops Plus, John Doe
and Mary Rowe,

Defendants.

NOTICE IS HEREBY GIVEN that the above-entitled action has been commenced and the Complaint therein is now on file in the office of the District Court Administrator above-named; that the names of the parties to said action are as above-stated; that the real property affected, involved and brought in question by said action is the tract of land in the County of Sherburne, State of Minnesota, described as follows, to-wit:

That part of the SE $\frac{1}{4}$ of the NW $\frac{1}{4}$ of Section 32, Township 34, Range 28, Sherburne County, Minnesota, described as follows:
Commencing at a point on the East line of said NW $\frac{1}{4}$ of Section 32, 1364.73 feet South of the Northeast corner thereof; thence deflect to the right in a Southwesterly direction 61 degrees 51 minutes, from said East line along the center line of Old County Road No. 4, a distance of 616.80 feet to the actual point of beginning of the land to be described; thence continue Southwesterly along said center line and the extension thereof 313.08 feet; thence Northwesterly at right angles 241.72 feet; thence Northeasterly parallel with said center line 313.08 feet; thence Southeasterly at right angles 241.72 feet to the point of beginning,

Notice is further given that this action is brought for the purposes of:

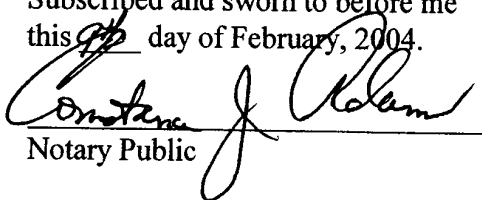
1. Declaring Plaintiff holder of a certain Mortgage dated April 24, 2002, covering property in the County of Sherburne, State of Minnesota, described as follows, to-wit:

That part of the SE ¼ of the NW ¼ of Section 32, Township 34, Range 28, Sherburne County, Minnesota, described as follows:
Commencing at a point on the East line of said NW ¼ of Section 32, 1364.73 feet south of the Northeast corner thereof; thence deflect to the right in a Southwesterly direction 61 degrees 51 minutes, from said East line along the center line of Old County Road No. 4, a distance of 616.80 feet to the actual point of beginning of the land to be described; thence continue Southwesterly along said center line and the extension thereof 313.08 feet; thence Northwesterly at right angles 241.72 feet; thence Northeasterly parallel with said center line 313.08 feet; thence Southeasterly at right angles 241.72 feet to the point of beginning,

2. Directing that a copy of that Mortgage be accepted for recording by the Sherburne County Recorder; and
3. Foreclosing said Mortgage.

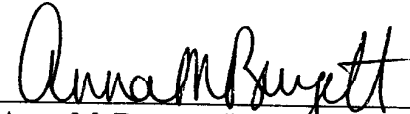
Dated: February 9, 2004

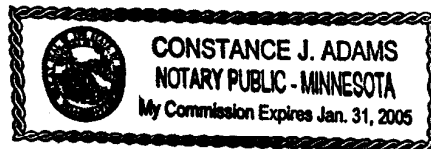
Subscribed and sworn to before me
this 9th day of February, 2004.


Notary Public

This instrument was drafted by:
WILFORD & GESKE
7560 Currell Boulevard, Suite 300
Woodbury, MN 55125
(651) 209-3300
Reference No. 070050-7006

WILFORD & GESKE

By: 
Anna M. Burgett, #0314353
Attorneys for Plaintiff
7560 Currell Boulevard, Suite 300
Woodbury, Minnesota 55125
(651) 209-3300



UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

Case No. 04-42047 NCD
Chapter 13 Case

In Re:

Brian T. Peterson and
Ginelle M. Peterson,

Debtors.

ORDER

This Chapter 13 case came on before the Court on September 29, 2004, for hearing on the objection of Debtors' to Claim No. 15 filed by Provident Bank/PCFS Mortgage Resources in the above captioned case. Appearances were as noted on the record. Upon the record made at the hearing, and the other files, records, and proceedings in the case,

IT IS HEREBY ORDERED:

That Debtors' objection to Claim No. 15 is overruled.

Date:

U.S. Bankruptcy Judge